HELLENIC REPUBLIC

MINISTRY OF ECONOMY AND FINANCE

THE 2007 UPDATE OF THE HELLENIC STABILITY AND GROWTH PROGRAM 2007 - 2010

December 2007

This update of the Hellenic Stability and Growth Program has been submitted to the European Commission in accordance with Article 4 of the European Council Regulation 1466/97.
The program can be found on the Ministry's web site: http://www.mnec.gr

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1 ECONOMIC POLICY FRAMEWORK

This update to the Hellenic Stability and Growth Program is the first one after Greece's exit from the Excessive Deficit Procedure. The abrogation of the EDP by the Council was recognition of the Greek government's success in bringing the deficit below 3% of GDP in a credible and sustainable manner, as well as of the great improvement in the transparency of fiscal statistics and stock-flow dynamics.

The key fiscal objective of the Greek government as displayed in the present Program is to continue the reduction in the general government deficit by at least 0.5 p.p. of GDP in structural terms until we reach the Medium Term Objective, as required by the preventive arm of the Stability and Growth Pact. The second objective is to reach fiscal balance by 2010. The continuing economic expansion at high growth rates provides the appropriate circumstances for building healthy fiscal finances. Importantly, the effort to further improve the transparency of fiscal statistics continues according to a well-specified action plan.

Fiscal consolidation is one pillar of the economic policy program the government is implementing aimed at enhancing productivity growth. Part of this consolidation is being redistributed as a social dividend in the form of targeted expenditure aimed at enhancing equity and social cohesion. The second pillar of the program entails structural reform in order to improve the business environment and facilitate private sector development, investment in productive capacity and job creation. Emphasis is also placed on enhancing the outward orientation of the Greek economy through facilitating Foreign Direct Investment, expanding the trade ties with the rest of the world, and greater openness.

The impact of ageing on the sustainability of Greek public finances is projected to be rather acute. The government's program to reach its Medium Term Objective rapidly helps to improve fiscal sustainability. However, reform of the pension system has to be part of the remedy. The government is preparing an important reform of the pension system next year. The aim is to make the system more fair, sustainable and efficient.

The rest of the Program is organised as follows. Section 2 presents recent economic developments, as well as projections for the 2008-2010 period. The overall economic policy strategy and targets for the general government balance and debt, as well as the underlying framework for economic and fiscal policy prospects are presented in Section 3. In Section 4, a sensitivity analysis is conducted and comparisons are presented between the current update of the SGP and the previous one. In Section 5, developments on public finances are presented, both on the expenditure and the revenue side. In Section 6 the issue of long-run sustainability of public finances is briefly taken up.

2 ECONOMIC OUTLOOK

2.1 World Economy – Technical Assumptions

Regarding the international economic environment, we have adopted the common external assumptions of the European Commission of autumn 2007. The basic technical assumptions underlying this Program are presented in the following Table.

Table 1. Technical assumptions

	2006	2007	2008	2009	2010
Short-term interest rate (annual average)	3.1	4.3	4.3	4.3	4.3
Long-term interest rate (annual average)	4.1	4.3	4.4	4.5	4.5
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.26	1.36	1.42	1.42	1.42
Nominal effective exchange rate	0.6	0.7	0.2	0.0	0.0
World excluding EU, GDP growth	6.0	5.6	5.3	5.4	5.5
EU GDP growth	3.0	2.9	2.4	2.4	2.5
Growth of relevant foreign markets	9.8	8.0	7.5	7.1	7.5
World import volumes, excluding EU	8.0	7.7	7.1	7.7	7.7
Oil prices (Brent, USD/barrel)	66.2	70.6	78.8	76.0	75.0

2.2 Cyclical Developments and Current Prospects

2.2.1 The Greek Economy in 2006

The Greek economy sustained a robust growth rate of 4.2% in 2006, 1.4 percentage points higher than the average growth rate of Eurozone countries (2.8%). Domestic demand had a positive contribution to growth in GDP of 6.65 percentage points, whereas the external balance had a negative contribution of 1.97 percentage points. Nonetheless, the contribution of exports of goods, 1.13 percentage points, was remarkable by historical standards.

The substantial contribution of investment to growth is also evident, as investment increased by 14.8% (in constant prices). Foreign direct investment inflows also increased significantly in 2006, amounting to € 4,275.4 mio or $ 5,370 mio, compared to a yearly average of about $ 1,000 mio throughout the 1990’s.

The increase in real disposable income of households by 5% (deflated by the CPI) was the main contributing factor to the increase of private consumption by 4.2% in constant prices. Total credit expansion to the private sector continued to increase in 2006 with a rate higher than 20%, adding momentum to both investment and private consumption. More specifically, credit expansion to enterprises accelerated to 16.6%, versus 14.7% in 2005, while housing loans increased by 25.8% versus 33.5% in 2005 and consumer credit increased by 23.9% versus 28.7% in 2005.

Exports of goods increased by 11.5% (in real terms), thus accounting for 26.8% of the overall rate of growth. The growth rate in exports market reached 9.8%, thus contributing to the acceleration of the rate of increase in exports. Exports of services in constant terms remained at the 2005 levels.

Domestic demand expansion, together with the higher price of oil, resulted in an increase of imports of goods by 14.5% in current prices, and of imports of services by 8.7%. The current account deficit, on a national accounts basis, was 14.4% of GDP up from 13.4% in 2005. It should be noted that a significant part of total imports is accounted for by machinery and equipment, thus supporting the growth potential of the economy.

Despite the significant increase in the price of oil, inflation remained on a decelerating path. CPI increased by 3.2% on average versus 3.5% in 2005. Core inflation reached 2.7%, down from 3.1% in 2005. The rate of employment, according to the Labour Force Surveys, improved to 61%, up from 59.4% in 2004 and 56% in 1998.

2.2.2 The Greek Economy in 2007

Economic activity remained strong during the first three quarters of 2007. GDP, in constant prices, increased by 4.1%, thus exceeding the annual growth rate forecast included in the update of the Stability & Growth Program (SGP) of Dec. 2006 (3.9%).

Exports and investment remain the main contributing factors to growth in 2007. The rate of growth of investment (including changes in stocks) was 9.3% during the first three quarters of the year, compared with 12.4% in the corresponding period of 2006. Moreover, Public Investment Program (PIP) expenditure grew by 6.3% at current prices in the January to October period. On the contrary, the volume of private building activity (according to construction permits), decreased by 5.5% (January – September period) versus an increase of 4.6% during the corresponding period in 2006.

Total final consumption (public and private) increased by 3.0% during the first three quarters of 2007. The growth rate of the volume of retail sales in the January-September period remained high (2.8%), while new private passenger cars increased considerably by 5.3%, after stagnating in 2006 (Q1-Q3).

Exports of goods and services grew, in constant prices, by 7.2% during the first three quarters of the year versus 4.2% in the corresponding period of 2006, while imports of goods and services increased by 8.3% (8.4% in the 2006 period).

Based on these developments, GDP growth is estimated at 4.1% for the whole year. This estimate exceeds by 0.2 percentage points the previous SGP forecast. Real average wage is estimated to increase by 3.2% and real gross disposable income by 4.1% (deflated by CPI), contributing to robust private consumption growth. The latter is expected to increase by 3.2%. Total investment is estimated to grow by 8.9% contributing 2.4 p.p. to the aggregate growth rate. The increase of private investment (excluding housing investment) by 13.7% is especially important as it contributes 2.2 percentage points to the GDP growth. Exports of goods and services are estimated to increase by 8%, contributing 1.7 percentage points to GDP growth, while imports, because of high investment in equipment and consumer durables goods, is expected to increase by 8.4%.

The unemployment rate has been on a steep downward trend since the 1st quarter of 2004 when it had reached 11.3% (LFS data). It fell to 7.9% in the 3rd quarter of 2007. The long-term unemployment rate fell from 5.7% in 2004 Q1 to 4.3% in 2007 Q3. For 2007, total employment is estimated to increase by 1.8% and the rate of unemployment is expected to reach 7.6% on a national accounts basis. The labour content of growth in the Greek economy has improved in the past few years: the elasticity of employment with respect to GDP is 0.5, approaching the corresponding elasticity in EU countries.

The inflation rate (measured by the CPI) up until September decelerated to 2.7% down from 3.3% during the corresponding period of 2006. In October and November inflation accelerated to 3.1% and 3.9% respectively, due to the significant increase of oil prices in euros (by 20.4% in October and 37.9% in November). At the same time the inflation rate in the Eurozone accelerated to 2.6% and 3.1% respectively. Despite this acceleration, the 11-month average (Jan.-Nov. period) headline CPI inflation rate remained below 3% reaching 2.8%. The inflation differential between Greece and the average of the Eurozone (measured by HICP) has gradually fallen from 1.3 percentage points in 2005 to 1.1 p.p in 2006 and to 0.8 percentage points in November 2007. Overall for 2007, the rate of increase in the private consumption deflator is expected to be 2.7%, down from 3.5% in 2006, i.e. 0.3 percentage points lower than the forecast included in last year's budget (November 2006).

High growth rates of the Greek economy in recent years, have led to significant progress in the real convergence process (vis-à-vis the average of the EU-27), with GDP per capita (in PPS) reaching 98.4% in 2007 up from 92.4% in 2003.

2.3 Medium-term scenario

The baseline scenario is based on the assumptions that the world oil market will stabilize and that the effects of the financial market turmoil will not spread widely. In particular, the negative effects on real economic activity in the EU will be minimized.

Real output, following an average growth rate of 4% over the past three years, is projected to continue to grow at its potential growth rate of 4%, over the program's horizon. Despite high oil prices and the persistent strengthening of the euro vis-à-vis the US dollar, GDP growth is expected to remain strong. This growth will be supported by a number of factors, such as lower personal income tax rates, implementation of investment projects within the new frameworks of the investment incentives law and the public-private partnerships, as well as from continued structural reform. The Greek economy will continue to enjoy the benefits of the full implementation of the first wave of structural reforms, while more reforms are in the pipeline.

Private consumption is expected to continue its robust expansion (3.4% on average in the projected period), driven by strong real disposable income growth (3.6%) and real wage increases in the order of 2.4%. Real income growth is underpinned by robust employment growth, lower unemployment, as well as by targeted income support measures and personal income tax cuts.

Robust employment growth (averaging 1.8%), boosted by strong economic activity, is projected over the forecast horizon. The unemployment rate is expected to decrease to 6% in 2010.

Private non-residential investment activity is underpinned by healthy corporate balance sheets, higher returns on equity, the completion of investment projects under the Community Support Framework and the implementation of business investment programs already approved by the investment incentives law.

Regarding the external balance, exports of goods and services are expected to remain dynamic. Supporting factors will include buoyant developments in neighborhood markets, domestic productivity gains, the positive outlook for European countries, strong tourist receipts, and higher shipping revenues following the expansion of the Greek shipping fleet. Imports are projected to keep pace with domestic demand. Consistent with these developments, the current account deficit will decrease slightly as a percentage of GDP throughout the program period.

In the next few years, inflation is projected to moderate, in line with gradually declining nominal unit labor costs (down from 3.7% in 2007 to 2.6% in 2010) and despite current global commodity price developments.

Table 1a. Macroeconomic prospects

	ESA Code	2006 Level bn euros	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. Real GDP	B1*g	175.8	4.2	4.1	4.0	4.0	4.0
2. Nominal GDP	B1*g	214.0	7.7	7.2	7.0	6.7	6.8
Components of real GDP							
3. Private consumption expenditure	P.3	128.2	4.2	3.2	3.5	3.4	3.4
4. Government consumption expenditure	P.3	26.7	-0.7	4.2	0.7	1.0	1.2
5. Gross fixed capital formation	P.51	48.0	14.8	8.9	10.5	7.3	7.5
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-0.4	-0.2	-0.1	-0.4	-0.1	0.0
7. Exports of goods and services	P.6	37.9	5.1	8.0	7.3	7.6	7.7
8. Imports of goods and services	P.7	64.6	8.7	8.4	7.8	7.2	7.0
Contributions to real GDP growth							
9. Final domestic demand		-	6.65	5.39	5.63	4.79	4.95
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-0.49	0.07	-0.24	0.31	0.08
11. External balance of goods and services	B.11	-	-1.97	-1.36	-1.35	-1.10	-1.02

Table 1b. Price developments

	ESA Code	2006 Level 2000=1	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. GDP deflator		1.217	3.4	3.0	2.8	2.8	2.7
2. Private consumption deflator		1.185	3.5	2.7	2.8	2.7	2.6
3. HICP			3.3	2.9	2.8	2.7	2.6
4. Public consumption deflator		1.267	3.4	3.5	3.7	3.6	3.6
5. Investment deflator		1.150	3.2	2.9	2.3	2.1	2.0
6. Export price deflator (goods and services)		1.236	3.4	2.2	2.1	1.9	1.8
7. Import price deflator (goods and services)		1.142	3.5	1.6	1.7	1.7	1.7

Table 1c. Labour market developments

	ESA Code	2006 Level	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. Employment, persons[1] (000)		4647.2	2.5	1.8	1.9	1.7	1.6
2. Employment, hours worked[2](mio)		8518.5	1.8	1.1	1.1	1.0	0.9
3. Unemployment rate (%)[3] (000)		434,5	8.6	7.6	6.8	6.3	6.0
4. Labour productivity, persons[4]			1.7	2.3	2.2	2.3	2.4
5. Labour productivity, hours worked[5]			2.4	3.0	2.9	3.0	3.1
6. Compensation of employees (bn euros)	D.1	76.7	9.3	8.6	7.9	7.6	7.6
7. Compensation per employee (thousands euros)		25.4	6.3	6.1	5.3	5.0	5.0

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

Table 1d. Sectoral balances

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-12.3	-12.8	-12.7	-12.5	-12.2
of which: - Balance on goods and services		-12.6	-12.9	-13.2	-13.3	-13.4
- Balance of primary incomes and transfers		-1.9	-1.7	-1.2	-0.8	-0.5
- Capital account		2.1	1.8	1.7	1.7	1.7
2. Net lending/borrowing of the private sector	B.9	-9.6	-9.9	-10.8	-11.4	-12.0
3. Net lending/borrowing of general government	EDP B.9	-2.5	-2.7	-1.6	-0.8	0.0
4. Statistical discrepancy		-0.2	-0.2	-0.3	-0.3	-0.2

3 GENERAL GOVERNMENT BALANCE AND DEBT

3.1 Policy Strategy

In June 2007, the ECOFIN Council abrogated the excessive deficit procedure acknowledging the substantial fiscal consolidation of the Greek economy over the last three years. Economic policy in Greece continues to focus on fiscal consolidation and structural reform. Pension reform is a particular priority next year. The government deficit remained below the threshold value of 3% of GDP for a second subsequent year, despite the unprecedented physical disaster last summer, which had adverse economic effects outside the control of the government. The improvement in the fiscal balance has been substantial, given that the general government deficit was 7.3% of GDP in 2004.

The government proceeds with the second phase of fiscal adjustment and the reform program, aiming at achieving a balanced budget by 2010, with annual reductions in the structural deficit of at least 0.5 percentage points of GDP.

3.2 Current general government developments and the Medium Term Objective

The 2008 Budget targets a general government deficit of 1.6% of GDP for 2008. The underlying magnitude of deficit reduction from 2007 is approximately one percentage point of GDP. The goal for the central government deficit for 2008 is 3.4% of GDP (on a budget basis).

The central government deficit in 2007 is estimated at 4.1% of GDP (on a budget basis) compared to the budgeted 3.95% of GDP. The general government deficit will be 2.7% of GDP compared to the budgeted 2.2% of GDP. The deviation from the budgeted figure is due to unforeseen, non-recurring events with adverse economic consequences. Events that added approximately 0.5% of GDP to government expenditure were: large wildfires during the summer and the subsequent emergency assistance measures, parliamentary elections, as well as the settlement of debt to Olympic Airways in accordance to Court rulings. An additional one-off expenditure of 0.5% of GDP entailed an increased contribution to the EU budget, due to the recent GDP revision, as well as the settlement of pending issues since the previous GDP revision. It is worth emphasizing that those expenditures are one-off in nature and resulted from events outside the control of the government.

In detail (see Table 2), total general government revenue has increased from 39.5% of GDP in 2006 to 39.9% of GDP in 2007. There has been a significant increase in indirect tax revenue, as the structural measures to combat tax evasion have paid off in terms of higher VAT revenue, along with higher excise taxes on fuel and tobacco products. In parallel, the reform of the tax system with the gradual reduction of corporate tax rates has left ordinary revenues stable.

The good performance of tax revenues is explained by:

- the adjustment from 1/1/2007 of the excise duty rates in oil products in compliance with EU directive of 2003/96/EU,
- the higher revenues in excise duty rates in tobacco and the increase in the duty of cell-phones,
- the adjustment of objective values in property taxation from 1/3/2007,
- and the reported improvement in the efficiency of the tax and custom auditing authorities.

Table 2. General government budgetary prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level bn euros	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-5.3	-2.5	-2.7	-1.6	-0.8	0.0
2. Central government	S.1311	-8.3	-3.9	-4.4	-4.4	-2.3	-1.6
3. State government	S.1312						
4. Local government	S.1313	-0.1	-0.1	0.0	0.6	0.0	0.0
5. Social security funds	S.1314	3.1	1.5	1.7	2.2	1.6	1.7
General government (S13)							
6. Total revenue	TR	84.6	39.5	39.9	41.1	41.7	42.3
7. Total expenditure	TE[1]	89.9	42.0	42.6	42.7	42.5	42.3
8. Net lending/borrowing	EDP B.9	-5.3	-2.5	-2.7	-1.6	-0.8	0.0
9. Interest expenditure	EDP D.41	8.8	4.1	3.9	4.0	3.9	3.8
10. Primary balance[2]		3.5	1.6	1.2	2.4	3.1	3.8
11. One-off and other temporary measures[3]		-0.97	-0.4	0.3	-0.1		
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		42.9	19.9	20.3	21.5	22.0	22.6
12a. Taxes on production and imports	D.2	*25.6*	*11.9*	*12.3*	*13.2*	13.6	14.1
12b. Current taxes on income, wealth, etc	D.5	*17.0*	*7.9*	*7.9*	*8.2*	8.3	8.4
12c. Capital taxes	D.91	*0.3*	*0.1*	*0.1*	*0.1*	0.1	0.1
13. Social contributions	D.61	28.3	13.2	13.3	13.5	13.6	13.8
14. Property income	D.4	2.0	0.9	0.9	0.9	0.9	0.9
15. Other[4]		11.4	5.5	5.4	5.2	5.2	5.0
16=6. Total revenue	TR	84.6	39.5	39.9	41.1	41.7	42.3
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]		66.6	31.1	31.5	32.8	33.4	34.2
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	**33.0**	**15.4**	**15.5**	**15.3**	**15.1**	**14.8**
17a. Compensation of employees	D.1	23.1	10.8	10.8	11..0	11.0	10.9
17b. Intermediate consumption	P.2	9.9	4.6	4.7	4.3	4.1	3.9
18. Social payments (18=18a+18b)		**35.5**	**16.6**	**17.2**	**17.8**	**18.0**	**18.3**
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
18b. Social transfers other than in kind	D.62	*35.5*	*16.6*	*17.2*	*17.8*	*18.0*	*18.3*
19=9. Interest expenditure	EDP D.41	8.9	4.1	3.9	4.0	3.9	3.8
20. Subsidies	D.3	0.3	0.1	0.1	0.1	0.1	0.1
21. Gross fixed capital formation	P.51	6.7	3.1	3.1	3.1	3.1	3.0
22. Other[6]		5.5	2.7	2.8	2.4	2.3	2.3
23=7. Total expenditure	TE[1]	**89.9**	**42.0**	**42.6**	**42.7**	**42.5**	**42.3**
p.m.: Government consumption (nominal)	P.3	33.9	15.8	15.9	15.5	15.2	14.9

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

The reduction in the general government deficit to 1.6% of GDP in 2008 is significant both quantitatively and qualitatively. Total general government revenues are projected to increase from 39.9% of GDP in 2007 to 41.1% in 2008. This improvement is carried over from 2007, due to measures already taken this year. Enhanced efforts to tackle tax evasion should also contribute to total revenue improvement.

On the expenditure side, government remains committed in 2008 to prudent policy, as spending remains relatively unchanged as a percentage of GDP compared to 2007. A marginal increase in total general government expenditure of 0.1 p.p. of GDP is projected. Moreover, efforts to restrain expenditure in 2008 have been enhanced by new legislation regarding fiscal audits and controls. So far, controls only referred to the legality and regularity of public spending as described in the Budget.

Lastly, the medium term objective of fiscal policy is to reach budget balance by 2010, with annual reductions in the structural deficit of at least 0.5 p.p. of GDP.

3.3 Structural Balance – Fiscal Stance

We estimate potential growth at 4.0 % on average for the 2007 - 2010 period (see Table 3). Based on that estimate, the cyclically-adjusted balance net of one-offs and other temporary measures in 2008 will reach 2.6% of GDP, down from 3.7% in 2006 and 3.2% in 2007. In the years ahead, the structural deficit falls further to 0.8 % in 2010. The improvement in the structural balance is substantial: 0.5 p.p. of GDP in 2007, 0.6 p.p. of GDP in 2008, 1.0 p.p. of GDP in 2009, and 0.8 p.p. of GDP in 2010.

Table 3. Cyclical developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Real GDP growth (%)		4.2	4.1	4.0	4.0	4.0
2. Net lending of general government	EDP B.9	-2.5	-2.7	-1.6	-0.8	0.0
3. Interest expenditure	EDP D.41	4.1	3.9	4.0	3.9	3.8
4. One-off and other temporary measures[1]		-0.4	0.3	-0.1		
5. Potential GDP growth (%)		4.1	4.0	4.0	4.0	4.0
Contributions:						
- labour		1.5	1.1	1.2	1.1	1.0
- capital		1.8	1.8	1.9	2.0	2.0
- total factor productivity		0.8	1.1	0.9	1.0	1.0
6. Output gap		1.2	1.3	1.3	1.3	1.3
7. Cyclical budgetary component		0.8	0.8	0.9	0.8	0.8
8. Cyclically-adjusted balance (2 - 7)		-3.3	-3.5	-2.5	-1.6	-0.8
9. Cyclically-adjusted primary balance (8 + 3)		0.8	0.4	1.5	2.3	3.0
10. Structural balance (8 - 4)		-3.7	-3.2	-2.6	-1.6	-0.8

[1]A plus sign means deficit-reducing one-off measures.

3.4 Debt levels and developments

Fiscal consolidation is evident not only in the general government deficit, but in the public debt as well (see Table 4). In 2007, the general government debt was 5.2 p.p. of GDP lower compared to 2004. It is projected to further decline to 82.9% of GDP in 2010. Increasing primary balances (from -2.4% in 2004 to 1.2% in 2007 and 3.8% in 2010), smaller stock-flow adjustment, privatisation revenue, and strong nominal GDP growth are all contributing positive factors.

In parallel, prudent debt management is supported by qualitative and quantitative risk analysis, precise evaluation of financial products and instruments and comparisons between them. In this way, the debt portfolio is efficiently adjusted to market conditions, with increasing predictability of the servicing cost and control over financial risk. As a result, interest payments on the debt are minimized.

In 2007, the issuance policy of some countries was affected by the financial crisis originating in the sub-prime mortgage market of the United States. This was not the case in Greece, where the financing of borrowing requirements was achieved without impediments, at a weighted average cost of 4.44% for an average duration of 15.1 years (for new borrowing) and with an oversubscription ratio of 3.83. For 2008 and for the program's horizon, the debt management strategy is expected to focus on:

- keeping the modified duration within the desired band of 4.3 - 4.5 years,
- keeping the ratio of debt with fixed and floating interest rates around the level of 80% - 20% respectively,
- developing new methods of measuring and assessing portfolio risks,
- keeping the percentage of debt which is refinanced or re-evaluated during the forthcoming 12 months below 35%,
- maintaining the proportion of debt with maturity of up to 5 years to less than 55% of the total portfolio.

Table 4. General government debt developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Gross debt[1]		95.3	93.4	91.0	87.3	82.9
2. Change in gross debt ratio		-2.7	-1.9	-2.4	-3.7	-4.4
Contributions to changes in gross debt						
3. Primary balance[2]		1.6	1.2	2.4	3.1	3.8
4. Interest expenditure[3]	EDP D.41	4.1	3.9	4.0	3.9	3.8
5. Stock-flow adjustment		1.9	1.8	2.0	1.4	1.2
p.m.: Implicit interest rate on debt[7]		4.8	4.7	4.8	4.9	4.9

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

4 SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE

4.1 An Alternative Scenario: Sensitivity of budgetary projections

In this section, we provide a sensitivity analysis of budgetary projections regarding the 2008-2010 period. A more ‘pessimistic’ growth scenario for the Greek economy is presented and its projections are compared to those of the ‘baseline’ scenario.

The alternative scenario considers a further deterioration in the US housing market, which could cause a hard landing of the US economy, exacerbating the global financial market turmoil. The global credit squeeze may impact negatively on both the EU and the Greek economy with exports, consumption and investment growth rates possibly being adversely affected.

In this second scenario, a slower annual GDP growth rate is assumed compared with the baseline scenario. GDP growth is projected at 3.8% in 2008, 3.5% in 2009 and 3.7% in 2010. Total demand is lower than in the baseline scenario and thus the inflation rate is projected to be slightly lower. Employment growth rates also remain below the reference value of the baseline scenario, while unemployment rates are consequently higher. As a result, the goal of a balanced budget is not achieved by 2010.

Table 5. The Baseline versus the Alternative scenario

	Baseline scenario			*Alternative scenario*		
	2008	**2009**	**2010**	**2008**	**2009**	**2010**
GDP growth rate	4.0	4.0	4.0	3.8	3.5	3.7
GDP deflator change	2.8	2.8	2.7	2.8	2.7	2.7
General government deficit, % of GDP	1.6	0.8	0.0	1.7	1.1	0.4
General government debt, % of GDP	91.0	87.3	82.9	91.2	88.3	84.6

4.2 Comparison with the previous update

We present in Table 6 deviations of the current SGP update from the 2006 one which covered the 2006-2009 period.

GDP growth projections for the period 2008-2010, as displayed in the present SGP, are quite similar to those of the previous update. The real GDP growth rate of 2007 is estimated at 4.1%, higher than the corresponding 2006 SGP projection by 0.2 p.p..

Public finances data as a percentage of GDP differ between the two programmes. One of the reasons for this divergence is that the National Statistical Service of Greece has proceeded with an upward revision of GDP by around 9.6%. Excluding this source of divergence, the general government deficit for 2007 is 0.5 p.p of GDP higher in the 2007 SGP projection than in the previous SGP update. The main reason is an increased contribution to the EU budget (1,110 million euros) - a one-off expenditure resulting from the new and higher GNI.

Table 6. Divergence from previous update

	ESA Code	2006	2007	2008	2009	2010
Real GDP growth (%)						
Previous update		4.0	3.9	4.0	4.1	---
Current update		4.3	4.1	4.0	4.0	4.0
Difference		0.3	0.2	0.0	-0.1	---
General government net lending (% of GDP)	EDP B.9					
Previous update (*)		-2.6	-2.4	-1.8	-1.2	---
Current update		-2.5	-2.7	-1.6	-0.8	0.0
Difference						
General government gross debt (% of GDP)						
Previous update (*)		104.1	100.1	95.9	91.3	---
Current update		95.3	93.4	91.0	87.3	82.9
Difference						

(*) Unrevised GDP data

5. QUALITY OF PUBLIC FINANCES

5.1 Developments on the expenditure side

The general government deficit is estimated at 2.7% of GDP this year and is expected to be further reduced to 1.6% in 2008. The main targets, as set in the 2007 State Budget, are expected to be achieved, despite the incorporation of an amount of € 1,103 million (0.5% of GDP), arising from emergency assistance after the wildfires of last summer, holding parliamentary elections, as well as the settlement of debt to Olympic Airways in accordance to Court rulings.

More specifically, the central government deficit for 2007 will amount to 4.1% of GDP on a budget basis (against a budgeted deficit of 3.95% of GDP), while the general government deficit is expected to reach 2.7% of GDP (against a budgeted general government deficit of 2.2% of GDP). This estimated outturn for the 2007 budget also incorporates an amount equal to € 1,110 million (0.5% of GDP), as a one-off contribution to the E.U. Budget, due to the recent GDP revision, as well as the settlement of pending issues since the previous GDP revision.

Total budget expenditure, excluding amortization payments, increased from 27.2% of GDP in 2006 to 27.8% in 2007, mainly due to non-recurring expenditure, as mentioned above. The expenditure on salaries is 5.9% higher than in 2006, but as a percentage of GDP it is marginally lower - from 6.4% (2006) to 6.3% this year. The total amount for salaries and pensions is maintained steady as a percent of GDP, at 9.1%.

The expenditure on social security and health care is estimated to grow by 14.9% in 2007 (increasing from 4.4% of GDP in 2006 to 4.7% this year), mainly due to increases in OGA (Farmers' pensions) by € 599 mio, in EKAS (Pensioners' Social Solidarity Allowances) by € 138 mio and LAFKA (Social Solidarity Account of SSF) outlays amounting to € 72 mio. Interest payments are slightly higher by 1.7% compared to 2006.

For 2008 total budget expenditure is forecast to change only marginally as a percentage of GDP, to 27.9%. This is so despite considerable increases in social expenditures aimed at strengthening social cohesion as well as the increase of Public Investment Programme funds, necessary to strengthen investment and boost growth.

The annual growth rate of primary expenditure is expected to decelerate from 11.7% to 7.3% between 2007 and 2008. The 2008 State Budget provides approximately € 950 million, an amount equal to 0.4% of GDP, as financial support to poor households. This amount will cover increases given to the Farmer´s Fund (OGA) and the allowance for low pension earners (EKAS), the increase in unemployment benefits and the funding of the National Fund for Social Cohesion. As a result, social security and health care expenditure is forecast to further increase to 5.1% of GDP next year.

The Ministry of Economy and Finance has submitted to Parliament a draft law regarding the establishment of a National Fund for Social Cohesion, which will finance targeted programmes and provide substantial support to poor households. Social transfers in Greece have proved quite ineffective given that only 13% of poor households manage to surpass the poverty threshold after social transfers (the corresponding EU average is equal to 38.5%). This is mainly due to the fact, that social transfers are not well targeted to those who are really in need.

The National Fund will be financed with an amount eventually reaching € 2 bn annually, and will provide support to poor citizens amounting to 1000 € per year on average. The government’s target is to reduce the poverty rate to 15% within the next five years.

In addition, increased expenditure amounting to € 670 million (almost 0.3% of GDP) is allocated for higher salaries and pensions for military staff, as well as extra benefits for the judiciary and for families with three children. Thus, expenditure for salaries and pensions is expected to rise to 9.2% of GDP in 2008.

The debt-to GDP ratio is expected to progressively decline to 82.9% in 2010, down from 98% in 2005 and 93.4% in 2007. For 2008, the general government debt is forecast to fall by 2.4 p.p. of GDP, the primary surplus contributing 2.4 p.p. The primary surplus will further contribute to debt reduction by 3.1 p.p. in 2009 and 3.8 p.p. of GDP in 2010.

5.2 Developments on the revenue side

Net revenue of the central government**,** according to the 2008 Budget, will amount to €60,052 million (€ 55,520 in ordinary revenues and € 4,532 million from the Public Investment Programme). Accordingly, revenues will reach 24.5% of GDP from 23.7% in 2007.

Despite the continuous reduction of tax rates on companies and households, tax revenues will rise by 12.9% next year, reaching 22.3% of GDP, from 21.1% in 2007. The personal income tax cuts, which were initiated this year, will be completed in 2009. Middle-income families will be taxed at a rate of 25% in 2009, instead of 30% to 40% as was the case in 2006.

The improvement in tax revenue collection is mainly a result of further tackling tax evasion, through the intensification of fiscal and customs audits and the restructuring of the system of fuel distribution. Further measures in this direction include tax incentives for consumers to request sale receipts and to comply with their tax obligations. Property taxation is also simplified and rationalised by introducing a unified property tax.

In November a new law was voted in Parliament, aiming at more effective efforts to combat tax evasion. The government intends to change citizens' and tax administration's attitude regarding tax evasion and establish relationships of trust and mutual respect between taxpayers and tax authorities. It aims at enhancing the effectiveness and objectiveness of tax audits and incentives are provided to taxpayers for requiring sale receipts, especially in branches where tax evasion is more intense. A National Committee for tackling tax evasion is established, with the participation of all social partners. A new tax analysis unit is established in the Ministry of Economy and Finance. A special mechanism is set in place in the Ministry for monitoring debts in tax offices and revenues and debts in customs offices. An annual report will be submitted to Parliament regarding the results of the conducted audits and the declared incomes of taxpayers.

BOX 1: The National Committee for tackling tax evasion and the tax analysis unit

The National Committee for tackling tax evasion is an advisory body to the Ministry of Economy & Finance. It will submit proposals for measures to prevent and correct lax tax implementation, especially in VAT cases and smuggling. Other proposals will aim at simplifying of procedures for better services to taxpayers. Social partners will also be invited to submit their own proposals. The Committee will meet twice a year and will be chaired by the Minister of Economy and Finance.

The tax analysis unit established in the Ministry of Economy and Finance will monitor, analyse and assess tax measures, follow international developments and best practice, and submit proposals on tax policy.

Much of the revenue increase budgeted for 2008 will come from a further crackdown on tax evasion. In addition, the government has recently submitted to Parliament a new draft law, equalizing the tax rate for home heating oil with diesel fuel used for transportation. This measure is aimed at stamping out widespread tax evasion in the petroleum market where home heating oil, subject to lower excise taxes, is used for other uses instead. Households will continue paying the reduced tax for home heating oil, while the tax difference will be reimbursed from the State to owners of filling/petrol stations, after the submission of lists with data on sales and purchases of petrol.

A draft law, submitted to Parliament in December, reforms and simplifies property taxation and has two main elements. First, it abolishes real estate inheritance taxes for close relatives. As with any transfer of real estate property, there will be a fee of 1% on the objectively defined value, instead. However, the acquisition of a first residence (up to 200 m^2) is exempted from this transfer fee. Second, a unique property holding tax is introduced, replacing a variety of taxes levied on real estate holding today. The rate is set at 0.1% for households and 0.6% for corporations. Again the primary residence of households is exempt, for houses up to 200 m^2 with objectively defined value up to € 300,000.

5.3. Structural changes in public expenditure and revenues

The government is launching two initiatives aimed at improving the quality of public finances. The first one is the introduction of Program Budgeting, aimed at improving the effectiveness of public expenditure. It will also facilitate multi-annual budgeting and enhance transparency in fiscal management. The second initiative is the implementation a new accounting system that will support a more accurate presentation of public finances and effective implementation of the State Budget. The Ministry of Economy and Finance will proceed with the incorporation of special extra-budgetary accounts in the general state budget, further intensify fiscal audits, and oblige public enterprises to provide accounting reports every six months.

BOX 2: Institutional Measures towards Improving the Budgetary Process

The 2008 State Budget was accompanied by a special report, consisting of:

A Presentation of the State's Budget, structured in functions and programs, the National Plan of Programs: In particular, the National Plan of Programs consists of functions and programmes pertaining to the Central Government. The first classification level consists of the functions, whereas the second one consists of the programs specifying all revenues and expenditures. The programs have been developed and classified in functions, according to the purpose and nature of the relevant expenditures (ordinary budget and Public Investment Budget).

A description of the programs: A preliminary description of the content of each program is included. There is a short reference to the State activities captured in each program. Each ministry may participate in one or more of the functions of the National Plan of Programs.

Pilot planning: As a pilot case study, a presentation of the function "Culture, Religion and Sport" is included.

Two new units are established within the Ministry to facilitate the improvement of the quality of public finances. The Unit for Government Budget Reform, with main responsibilities the introduction of a program budget structure, a multi-annual budget framework and the development of an assessment framework for budget outcomes. The Unit for Government Accounting System Reform, with main responsibility the transition to an accounting system on an accrual basis.

5.4 Quality of Fiscal Statistics

In tandem with fiscal consolidation, the Greek government is continuing to pursue improved transparency and accuracy of fiscal statistics. For the period 2003-2006 the statistical discrepancies, as a stock-flow adjustment factor, remained cumulatively at a negative value (-0.1% of GDP), indicating the good quality of Greek fiscal data.

The Greek government established last year an action plan for a further improvement of statistical methods, enabling an even more timely and reliable compilation of fiscal data in the general government. In line with this Plan, and according to Act 3557/2007, all social security funds are required to produce financial accounts according to IFRS in 2008. Moreover, a supervising committee for the implementation of public sector accounting standards in other general government entities is to be established soon.

The NSSG, in cooperation with Eurostat, has completed a major revision of the national accounts system, based on the 2001 census of population as well as a new series of structural surveys on construction, transport and hotel services. According to the revised figures, that use 2000 as the base year, Gross Domestic Product (GDP) is estimated to be higher by 9.6 percent. The analysis in this update of the SGP is based on these revised figures, which are presented in the Tables throughout.

6. LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES

Ensuring the long-term sustainability of public finances poses a significant challenge for Greece and, consequently, is a top priority in the government's policy agenda. According to the latest common projections,[1] the old-age dependency ratio is projected to increase from 26% in 2004 to 60% in 2050. According to the 2006 EPC Ageing Report, these demographic developments were found to increase age-related spending in the 2004-2050 period by 1.2% of GDP over the expenditure items for which projections were carried out (healthcare, unemployment benefits and education). Although pension spending was not included in the 2006 common projections, the latest estimates available so far (included in the 2002 update of the Stability Programme) indicated a significant increase in gross pension expenditure by 10.2% of GDP between 2005 and 2050.

The government is committed to safeguard the sustainability of public finances by adhering to a three-pronged strategy aimed at:

(a) reducing the debt-to-GDP ratio and achieving fiscal balance or surplus by 2010,

(b) consolidating the budgetary items with the highest risk, notably through a comprehensive reform of the social security system and

(c) raising employment rates and accelerating productivity growth by implementing an appropriate policy mix of structural reforms, in line with the goals of the Lisbon Strategy.

The fiscal policy implemented in the last three years has led to a significant reduction in the debt-to-GDP ratio. A further fast decline in this ratio is projected in the coming years.

[1] European Economy, *Special Report No. 1/2006*: "The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050)".

6.1 Pension Reform

A crucial factor is the ongoing public consultation, aimed at securing political and social consensus on pension reform. The government places significant weight on the ongoing process and is determined to achieve the broadest possible consensus. Over the past 15 months there has been considerable progress in taking stock of the current state and future prospects of the social security system by the competent Advisers Committee. An updated actuarial study has been commissioned to ILO and final results are expected by June 2008. Current actions focus on restructuring the administrative framework of the social security system, including the institutional framework for the operation of pension funds.

These involve:

- the consolidation of primary and auxiliary funds and their respective inclusion in IKA and ETEAM,
- the development of the national registry for social security and the issuing of a single social security number,
- a new framework regarding the management of funds' assets aimed at improved efficiency along with achieving economies of scale,
- the obligatory use of business plans and actuarial studies by social security funds,
- the development of an IT interface linking social security funds, with the aim to improve monitoring and to facilitate informed policy design.

Policy options that have recently been raised within the ongoing Parliamentary dialogue include:

- further consolidation of primary and auxiliary social funds,
- the review of early retirement provisions – including an update of the list of arduous and unhealthy occupations,
- the rationalization of disability pensions,
- increased incentives for extending working lives and
- measures against social security contribution evasion.

6.2 Reforms in the National Healthcare System

Meanwhile, the National Healthcare System (NHS) is being reformed with the aim to improve financial, managerial and administrative control. Ongoing reforms are covered in detail in the 2007 Lisbon Implementation Report and include:

- The new legislation (Law 3580/2007) concerning NHS procurement, aiming at the financial restoration and modernisation of the National Health System. Expected savings in the first year of implementation are estimated at € 500 million.
- **The reform in the regional structure of the NHS** (Law 3527/2007), resulting in seven distinct Regional Health Authorities down from seventeen. The new structure aims at improving effectiveness and efficiency, while strengthening the regional structure of the State. Expected benefits include:
    - Estimated annual savings of € 26.1 million through increased economies of scale.
    - Rational and timely planning of the annual financial, technological and human resources.
    - Improved administration and reduced bureaucracy.
    - More effective communication and co-ordination.
    - Improved financial, managerial and administrative control.
- The development of an independent, integrated Primary Health Care Network, introducing the creation of Electronic Medical Record and the activation of the family doctor (GPs). The implementation of the PHC Network aims to reduce hospital congestion, which will result in savings in financial, human and technological resources and will eliminate delays in access to care.
- The new legislation on medicine policy (Law 3547/2006), which aims, inter alia, at rationalising expenditure by insurance bodies, resulting in valuable savings. The necessary mechanisms are being progressively developed, including the introduction of the bar-code system to pharmacies, facilitating electronic registration, data processing and tractability of pharmaceutical

products. Meanwhile, the Organisation for the Medical Care of Civil Servants (OPAD) is supervising and monitoring doctors' prescriptions, as a pilot for all the other social security organizations.

- The introduction of modern management methods and strict rules of rational financial management in mental health institutions, aimed at increasing transparency and effectiveness in fiscal management.
- In addition, the utilization of Public Private Partnerships for construction and maintenance of NHS infrastructure has resulted in projects in the amount of € 1.5 billion, creating directly 5000 new jobs.

6.3 Increasing employment and productivity

Given the projected, sharp deterioration in the old-age dependency ratio, labour force shortages will have a toll in the future rate of potential economic growth. In particular, according to the EPC 2006 Ageing Report, average annual real GDP growth will drop to 0.8% between 2030 and 2050, compared to the observed 4% during 2005-2007. In this context there is increased scope for raising the utilization of potential labour input, by raising employment rates and encouraging participation in the labour market.

An important dimension of the solid economic growth between 2005 and 2007 has been the accelerated employment growth and the reduction in the unemployment rate. Average annual employment growth in the period 2005-2006 was 1.4% compared with 0.96 during 1992-2004 and it is expected to accelerate further to 1.8 in 2007. In addition, the unemployment rate fell from 10.5% in 2004 to 8.6% in 2006 – the lowest level since 1994 – and is expected to be further reduced to 7.6% in 2007 and 6.8% in 2008. These developments are in contrast with previous years, when high GDP growth failed to translate into increased employment and, when it did (primarily due to Olympic Games preparations), the employment inflow did not seem to be associated with re-employment of unemployed workers.

Significant action has been taken in order to promote female participation, with encouraging results. Active promotion of gender equality, investment in childcare and social care infrastructure, as well as promotion of part-time employment has facilitated an increase in the female employment rate from 45.2 in 2004 to 47.4 in 2006.

Further measures include tax incentives to make work pay, the increased emphasis on active labour market policies, re-training and life-long learning, as well as stricter eligibility criteria for unemployment benefits.

Finally, increased emphasis is placed on raising productivity by developing human capital, reforming the educational system (e.g. recent reform in tertiary education), but also by opening up markets to competition and facilitating the spread and uptake of ICT. A key area of focus remains the improvement in the efficiency and effectiveness of the public sector.